COMPETITION AND GROWTH

Gloria Bartoli

1. INTRODUCTION

Growth is the challenge for Europe now and in the years to come.

Growth is the only solution to unacceptable levels of unemployment and especially youth unemployment in many important EU countries.

Growth is the objective of competition policies.

After the global financial crisis, it has been apparent that the Maastricht indicators on public debt and deficit were not so useful to achieve Stability & Growth. Ireland has been a textbook example. Its 25% public debt to GDP ratio, well below the 60% limit, and a decade of close-to-balance or surplus fiscal positions were unable to shelter the country from the direst consequences of the financial crisis.  

For this reason, the EU added 10 indicators to its new system of economic governance in 2012. These indicators form a scoreboard for early warning of crisis in the framework of the Macroeconomic Imbalances Procedure. Such procedure doesn’t start at the tilt of one decimal in the indicator: internal or external imbalances give rise to in-depth reviews and recommendations that, if unattended, may initiate an excessive imbalance procedure, with the possibility of sanctions. Italy is under an “In-Depth Review” by the Commission because of excessive public debt and large loss of competitiveness. While all imbalances impair growth through different channels, loss of competitiveness - measured as reduced export share - reduces growth directly. Almost every EU country has experienced a loss of competitiveness, but to different extents. This is displayed in the following graph, where Italy and France show a much more negative trend than Germany, Netherlands and Spain in the period 1999-2011.

For an export-led economy like Italy, obstacles to competitiveness represent a major stumbling

1 Member of the Senior Advisory Board of the Italian Ministry of Economy and Finance. Speech held at the European Competition Day, Rome, 10 October 2014.

block to achieve growth and, as a consequence, a lower debt/GDP ratio.

Competitiveness is also measured by the Real Effective Exchange Rate (REER) which adjusts nominal effective (trade weighted) exchange rates by the appropriate foreign price level and deflates by the domestic price level. However, several non-price factors determine competitiveness: Kaldor showed some decades ago that advanced countries were increasing their exports even with rising labor costs.

2. **COMPETITIVENESS DEPENDS DIRECTLY ON PRODUCTIVITY AND THIS, IN TURN, ON COMPETITION**

Competition ensures productive efficiency through the resource efficiency channel, which leads to lower costs and prices, and the entry/exit channel. Competition ensures *dynamic efficiency* through the innovation channel, and finally it ensures *allocative efficiency*.

Recent research presented at an OECD-NBER conference on “Productivity Growth and Innovation”3, shows that cross-country differences in the level and growth rate of per-capita income are due to the efficiency with which inputs are used, that is Total Factor Productivity (TFP).

Also a growth accounting exercise for Italy shows the role of TFP as the leading factor of the rise and fall of growth, the only component that consistently explains real GDP growth in comparison with the EU 15 growth in the same decade.

Solow wrote that TFP is the measure of our ignorance, but since the 50s, when he was writing, we have dissected TFP and we know its major components: in Italy these components are civil justice inefficiencies as well as regulatory privileges to professions and inefficiencies of PA 4in addition to managerial capabilities and technical progress.

3. **INSTITUTIONS AS COMPONENTS OF TOTAL FACTOR PRODUCTIVITY**

The effectiveness of civil justice is measured by the number of days needed to reach a judgment at the first, second instance and at the highest

---


court. Italy is the worst performer among OECD countries for each type of instance.

The first effect of the inefficiency of civil justice is to discourage any honest entrepreneur from investing, as well as FDIs. High tech entrepreneurs - who are so important for technological spillovers and as providers of high quality jobs - are particularly discouraged from investing as they must protect also their intellectual property rights. Why should anyone invest in a country where it is impossible to rely on the delivery of inputs as well as the payment of outputs? Where it is preferable to accept payments lower than agreed rather than face several years of legal expenses? This explains why Italy was the smallest recipient of FDI in 2012 and 2013 among the top 20 host economies, a trend that should be reverted by the successful completion of the reform of civil justice already started.

Moreover, weak contract enforcement could lead firms to adopt inefficient technologies, for example those that minimize dependence on other firms, with detrimental effects on productivity.

Instead, a good enforcement of contracts stimulates agents to engage in economic transactions by dissuading opportunistic behaviour and reducing transaction costs. This has a positive impact on growth through various channels: it promotes competition, fosters specialization in industries where relationship-specific investments are most important, facilitates employment, contributes to the development of financial and credit markets and facilitates firm growth. India and Italy share a common characteristic on this aspect: the size of firms is often determined by the size of family: you can trust only family members if you cannot trust the rule of law. This constrains firm size and in turn productivity through bad management and suboptimal strategies, in particular towards internationalization. No matter how bad a

manager your brother-in-law is, you are stuck with him.

The length of legal procedures provides an incentive to disregard the law or to use it to extend the time before paying what is due. Such length is the result of supply and demand of justice: the structure of the Courts, civil trials procedures, use of ICT technologies, selection of judges and their governance affect the “supply” side of justice. Number of lawyers, anti-competitive regulations including minimum tariffs for lawyers established by Parliament, lack of filters for the selection of lawyers able to plead in front of the appeal courts and Highest Court (Corte di Cassazione) determine the demand side of justice.

When 40,000 lawyers in Italy can plead in front of the Highest Court - versus 39 in Germany - you need a Highest Court with more than 400 judges. Such a high number makes impossible for them to coordinate and produce consistent judgments, that is, to provide jurisdictional guidance. This allows any lawyer to start any litigation or challenge any judgment. This explains the number of 244.000 lawyers in Italy, with more lawyers in the city of Rome than in the whole of France. The number of lawyers who can plead without any filter to all three levels of judgment, together with the asymmetrical information that characterizes the relation between lawyer and client, generates 4 million cases per year. At the end of 2012 there were 9.7 million pending cases, of which about 5 million were civil cases. No improvement in the supply side of justice can deal with such number of new cases.

Considering this data, the fact that annual FDI inflows in Italy over 2005-11 were as low as 1/3 of the euro area average as a percent of GDP is hardly surprising. Thus, the reform of civil justice, one of the priorities of the present Italian Government, can be considered the most important measure of industrial policy.

According to the European Commission’s country-specific recommendations and the World Bank’s “Doing Business” report, the existing regulations of professions and the judiciary’s structures are not the only causes of the fall in productivity in Italy. The bottlenecks created by the low productivity of the Public Administration, in particular local public services, utilities and transport, are another cause of the loss of competitiveness. They are the object of other reforms under discussion at the Parliament and are sectors often dealt with by the Competition Authority. Liberalization of regulated professions like lawyers will improve productivity and growth. It is estimated that the rise in growth from such reforms can reach more than 4% in the long run (MEF Sept. 2014) or, according to IMF 2013, around 3,5% in 5 years and almost 7% in 10 years. However, the largest benefits will derive from the simultaneous implementation of all needed reforms, as we’ll see later.

Labor productivity of the non-tradable sector is not only lower than productivity in the tradable one, but its trend is flat and doesn’t respond to economic events (see below).

Labor productivity by sector: need to improve non-tradable.

4. **Since this trend concerns non-tradables, how can it affect Italy’s competitiveness in global markets, as measured by the decline of its export market share?**

Seminal work\(^7\) by Grillo, Allegra, Magnani e Forni of the Italian Anti-trust Authority shows that non-tradable inputs and service providers are the most uncompetitive sectors defined as those that incurred in antitrust interventions with a higher frequency than a given threshold. The study finds that the overwhelming majority of antitrust interventions - by the Italian Anti-trust Authority and the Bank of Italy - concern intermediate goods providers and service firms selling in the domestic market. Key sectors providing services for firms - finance and credit intermediation, insurance, professional services (lawyers, architects, accountants etc.), energy, telecommunications, transports - are affected by substantial antitrust problems. Ten year after the Grillo et others study, the picture - offered by the table below - hasn’t changed substantially, but for telecommunications which were effectively liberalized.

At the top of the list of antitrust law infringers in 2001 were telecommunications, professional services and financial intermediation, the last two being historical champions of rent-seeking and the objects of several other studies that have proved their ability to impair growth\(^8\). On the receiving side, exporting firms, facing international competition, cannot completely

---


adjust their prices to the higher than international costs of their service providers, which are sheltered from competition. By using input-output tables to analyze links among sectors, the Italian antitrust study reinforces this result by finding that the negative effect is stronger for the final sectors, which depend more heavily on intermediate inputs and services of the non-competitive sectors. The most dependent sectors perform worse in terms of net exports, export growth and output growth.

By using the input-output method just described and detailed indexes of regulation in Energy, Transportation, Communication (ETCR) and in Business services and retail (RBSR), the OECD created an Index of Regulation Impact (below) in order to measure the potential cost of anti-competitive regulations of services on manufacturing.

### Index of Regulation Impact

![Graph showing Index of Regulation Impact](image)

Source: OECD

Therefore, we have the data and the tools to improve competition in a sector in which antitrust policy could directly benefit growth with a strength and durability that can hardly be overestimated. It could also benefit growth indirectly. Rent-seeking, if unchecked, has very natural increasing returns. This means that a country can witness the attraction of the best brains to these sectors, depriving the economy of human capital in productive occupations. Moreover, rent-seeking by government officials hurts new and innovating activities more than established firms. Since innovation drives economic growth, liberalizing measures towards the public administration would have a disproportionately large and positive effect on growth.

![Graph showing Ability of innovative firms to attract capital](image)

Source: OECD

Another positive by-product of pro-competition policies in this field is that rent-seeking gives rise to income inequality of the worst kind: not of the kind that increases output, thus reabsorbing inequality, but of the kind that increases output, thus reabsorbing inequality, but of the

---

9 An increase in rent-seeking activities may make rent-seeking more (rather than less) attractive relative to productive activity. This condition can lead to multiple equilibria in the economy, with “bad” equilibria exhibiting very high levels of rent-seeking and low output, from Kevin M. Murphy, Andrei Shleifer, Robert W. Vishny, *The allocation of talent: implications for growth*, (cited above).
kind that reduces output, thus perpetuating inequality.

5. WORLD BANK’S “DOING BUSINESS” VERSUS OECD’S PMR, OR THE IMPORTANCE OF IMPLEMENTATION

Many services for production are delivered by the Public Administration, from building permits to utilities provision and tax collection. Indicators like the World Bank’s “Doing Business” rank Italy at the bottom of advanced countries for efficiency in these areas, which are crucial to attract investments, either national or foreign.

Instead, Product Market Restriction (PMR) indicators developed by the OECD have been steadily improving for Italy in the last years. The PMR indicators focus on measures that can curb competition with administrative burdens, start-up costs, antitrust exemptions for State owned enterprises, legal barriers or restricted access to networks, access to professions, barriers to entry of new firms, trade and FDI restrictions. They are very similar to the Doing Business indicators.

Despite the improvement of the PMR indicators, Italy has not experienced positive effects on output, employment nor FDI. Therefore, the sobering story on the Italian business climate of the Doing Business indicators seems more appropriate. The explanation of such divergence in rather similar indicators is in their source of information: the PMR indicators are based on the liberalizing laws “approved” rather than on their actual implementation, which is better captured by the survey of law firms done by the World Bank.

In fact, the lack of benefits for the economy depends on the lack of implementation - total or partial - of the reforms. It justifies the focus of the present government’s activity on providing the subsidiary legislation and ministerial decrees needed to make the reforms work.\(^\text{10}\)

Full implementation of structural reforms and streamlined competition and regulations could increase growth by almost 1% annually in the short and medium term, up to more than 8% in the long run, as shown by the estimates of the Update of the budget law in the table below.

\(^\text{10}\) In the Autumn 2014 the Italian Government halved the backlog of subsidiary legislation for the reforms of 2012 and 2013. Still 400 specific pieces of legislation are needed to complete those reforms.
losses of potential output. This is due to the increased ability of a competitive business climate to reallocate resources across firms and sectors in the aftermath of an adverse shock, thereby increasing the resilience of the economy.\textsuperscript{11}

6. INNOVATION

In addition to institutions, regulated professions, public local services and managerial ability, there is another component of TFP: technological progress. Concerns for secular stagnation based on diminishing technological progress do not seem based on evidence. They are in part due to present systems of national accounts that are designed for “wheat and steel economies”, and are unable to measure the information and leisure activities. On the contrary, there are many scientific discoveries that only start being transformed into innovations\textsuperscript{12} to be used as production processes or final products. But obstacles to competition can impair productivity because innovations can be blocked by entrenched interests protecting their rents. In this case, prices are sticky also in the medium term and innovations translate into job losses and rents.

Italy lags behind other advanced countries in adopting ICT technology. Thus, it has cumulated what Gershenkron called a “great advantage of backwardness”. It means that the further an economy lags behind the frontier, the bigger the productivity improvements can be when it innovates by implementing the frontier technology, and the further it can grow.

The two main channels to create innovation are R&D and FDI. R&D is a major tool not only to create innovation, but also to create the skills that enable an economy to adopt new technologies developed abroad. More efforts are needed in linking academic teaching to applicable innovations. As for FDI, we have already described how they are discouraged by the inefficiency of civil justice in enforcing contracts and the dissuading role of other components of the business environment.

The reform of the labor market and unemployment benefits (Jobs Act) recently approved by the Italian Parliament is a crucial step in removing the obstacles to factor reallocation and new investments, as are the reforms of the Public Administration and of civil justice, that have already been initiated.

7. CONCLUSION

In conclusion, the Antitrust Authority has a fundamental role in promoting growth through the resource efficiency channel, by enforcing the structural reforms that liberalize the non-competitive sectors of the economy. These are


\textsuperscript{12} Joel Mokyr, The long-term future of productivity, OECD-NBER Conference Sept. 2014.
mostly non-tradable sectors, regulated professions, and local public services. Moreover, Antitrust policies may increase growth through the innovation channel, by making sure that innovations translate into growth rather than in more rents for incumbents and less jobs. In fact, if markets are not competitive, prices are sticky and innovations translate into rents. On the contrary, in competitive markets, increases in productivity decrease prices of the products, and increase demand, investments and jobs.